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THE NEEDED CURRENCY REFORM

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OUR present national banking and currency system was hastily devised under the financial stress of the Civil War, primarily to sustain the Government in a dire emergency. It was intended to support the public credit by assuring a market for a large volume of Government bonds and supply a national currency to replace the inadequate and largely discredited issues of State banks. This was to consist of notes issued by a new system of banks organized under Federal authority on security of these bonds to more than the full amount, deposited with the Treasurer of the United States. A strong inducement was offered in the high rate of interest on the bonds and relief from the direct obligation to redeem the notes on demand.

The state of public sentiment forbade establishing any central institution like the old United States Banks or copying the plan of the great dominating banks of European nations. The model had to be drawn from the incongruous medley of State banks, and not the best plan among these was selected for the simple reason that it was not best adapted to the immediate purpose. Under a general suspension of specie payments a preliminary step had been taken by an issue of Government legal-tender notes which were to serve as reserve money in the absence of coin. The

national banking and currency system may almost be said to have been improvised in 1863, by men who were not experts at the task, to meet a financial emergency with which the Government was desperately struggling. It was somewhat improved in the following year, but has undergone only slight modification in its essential features since.

Since it was established there has been a vast industrial and commercial development, with an enormous multiplication of daily transactions in the exchange of values and credits. The use of drafts and checks upon bank deposits as a means of making payments by the transfer of credit from one to another has grown to vast proportions, until from ninety to ninety-five per cent. of business transactions are effected by means of them. The full significance of the use of these orders upon bank deposits as a credit currency is not generally appreciated. It should be understood that the deposits themselves consist only in small part of money, not at all of money which continues to belong to the depositor. They are credits granted by the bank to its depositors and are largely created by loans to them upon their credit satisfactorily secured. Whatever cash may be deposited goes into the funds of the bank and helps to maintain its reserve for meeting demands for cash payments.

Checks in common use are orders upon banks for payments to those in whose favor or to whose order they are drawn, and they effect a transfer of credits from one to another in the same bank or in different banks. They may be paid in money if it is demanded, but for the most part they are received in deposits and simply transfer credit from one to another, the bank assuming the task of collecting from other banks when the checks are not drawn upon itself or its own depositors. Drafts upon persons for money due are handled in a similar way through the banks. The volume of checks and drafts continually flowing into and out of the banks, transferring credits and being exchanged and balanced against accounts, constitute the great bulk of the currency of the country for trade purposes. It passes from hand to hand to only a limited extent by indorsement, and, as coin is hardly used except for small payments, there is need of a convenient "circulating" medium in the form of notes with which ordinary payments may be made. While this requirement is small compared with the volume of transac-

tions effected by checks and drafts, it is nevertheless of large magnitude and importance. There is need of a considerable volume of convenient currency to pass from hand to hand in the multitude of daily payments. The best form for this is that of circulating notes issued by banks, payable by them in coin on demand, and so secured that they will always be redeemed in actual money whenever the demand is made.

Our present banking system has two chief defects. One is the lack of note issues which can be adjusted by normal expansion and contraction to constantly varying needs. The other, by no means of less importance, is a plan of cash reserves held against deposit liabilities which seems to have been ingeniously devised to cause trouble in time of disturbed confidence. Under the old State system cash reserves, consisting invariably of coined money, were chiefly regarded as a provision for redeeming notes. Deposits were made mostly in bank-notes and paid in the same medium, the genuine notes of all banks being indifferently accepted and paid out. There were no definite reserves held against deposits, and requirements for those kept for the redemption of notes differed in different States, where there were any legal requirements at all.

When the national banking system was established it was required that a certain percentage of " lawful money " be held always at command for the payment of deposits in cash. As there was then a suspension of specie payments and the Government's own notes were a legal tender for the payment of debts, the reserves consisted chiefly, in most of the country wholly, of these notes, or " greenbacks." None of them were held as a means of redeeming the notes of the banks, which were secured by the deposit of Government bonds with the Treasury at Washington and were redeemable only there. A number of reserve cities were designated by name, only sixteen at first for the whole country, but subsequently increased in number from time to time until now there are over forty. New York, Chicago, and St. Louis were designated as Central Reserve Cities, and no additions have been made to these.

All national banks outside of reserve cities were required to have cash reserves equal to fifteen per cent. of their deposits, but they were permitted to keep three-fifths of these on deposit in banks approved by the Secretary of the Treasury in some reserve city, making it unnecessary to

hold more than two-fifths in " lawful money " in their own vaults. Reserve city banks were required to have cash reserves equal to twenty-five per cent. of their deposits, but one-half of these might be kept on deposit in banks in one of the central reserve cities, the other half only being held in their own vaults in " lawful money." Thus three-fifths of the reserves of what are commonly called " country banks," or those outside of reserve cities, might be in the form of mere credits held as deposits in reserve city banks, while half the reserves of the latter might be credits constituting part of the deposits of central reserve city banks, against which their own reserve of twenty-five per cent. was held. Owing to the tendency of exchange operations to New York, as the financial center of the nation, the ultimate resort of reserve money was to that city. This consisted virtually of legal-tender notes of the Government, until the resumption of specie payments in 1879, and provision for the redemption of these notes in coin. Since then they have consisted more and more of coin or gold and silver certificates representing coin deposited with the Treasury to the full amount. Another complication was due to an increasing number of State banks having different reserve requirements, which centered largely upon the " approved reserve agent " banks of the national system.

Of the working of this reserve plan there has been plenty of experience, and it is easy to understand. Since it was established the number of national banks has grown to nearly seventy-five hundred, with an aggregate capital of over a billion dollars and deposits of about six billions, and there are more than twice as many State banks. Each bank in the national system is independent in its operations, except so far as it is made subject to examination and supervision by the Comptroller of the Currency, with a view to enforcing compliance with the law, or it voluntarily submits to the rules of a Clearing House Association in cities where such organizations exist. In ordinary times of confidence and steady business there is no strain upon bank reserves and they are easily kept up to the legal requirements. There is little direct demand for " lawful money " by depositors, and the chief effect of the legal limitation is to put a restraint upon undue extension of loans, which are credited to borrowers as deposits to be drawn upon. That part of country bank reserves on deposit in reserve

cities and the reserves of reserve city banks on deposit in central reserve cities are kept in use as if belonging to the current funds of the banks in which they are deposited so long as the percentage of final reserve is maintained. In addition, the country banks may have other funds deposited in reserve and central reserve city banks to meet the requirements of exchange or to be loaned out when that can be profitably done.

While all works smoothly in ordinary times, this reserve plan creates a precarious situation. Whenever there is an unusual demand for money away from reserve cities, and this occurs every year in what is called the "crop-moving season," there is a heavy drawing upon the deposits kept in reserve cities and through them upon deposits in the central reserve cities, and especially at the main reserve center, New York. This is apt to occur when money is most in demand in those cities. The banks there have to yield up the reserve deposits on demand, and this may be required in "lawful money" to strengthen reserves elsewhere, and they have no resource of their own for strengthening reserve except acquiring gold or retrenching their loans. The effect is to advance money rates and restrict borrowing, and the rigid currency system prevents relief by expanding issues of bank-notes.

The effect of this annual strain is costly, but it is as nothing compared with what happens when there has been an undue extension of credit through overtrading, speculation, or other cause, and confidence becomes seriously impaired. This makes a financial crisis, which might otherwise be averted, withstood, or comfortably tided over, a disastrous affair through the attendant panic. There is no final resource beyond the banks to pin confidence to, and the banks have no means of associated effort except what they may improvise for the emergency. In the disturbed state of mind everybody wants to be paid what is due him and nobody wants to pay more than he is obliged for the time being to pay. The banks need to be exceptionally accommodating at such a time, but it is out of their power. Depositors make demands for actual cash in unusual number, which draws upon reserves and restricts loans. Country banks call home the reserves held on deposit in reserve cities and reserve city banks have to draw upon their reserve agents in central reserve cities. The whole strain con-

verges on the financial center at New York, where the banks have no resource but to unite their energies by voluntary association through the Clearing House and otherwise, to get Government deposits so far as they can, to import gold so far as they have the means, and to issue certificates based upon securities for settling balances with one another, or sometimes to serve in a limited way as currency. They must strengthen and sustain the weak places in the fabric of credit to prevent breaks which might cause a collapse of the whole structure affecting the industry and trade of the country, from which it would require years to recover.

It is not necessary to descant upon the causes or calamitous results of crises, panics, and depressions. It is enough to be reminded that in this country for forty years and more these have been partly caused and greatly intensified by our defective banking and currency system, which has left the financial community almost helpless to avert, resist, or overcome the tendencies developed in bringing them on, even when they are foreseen and counted upon. Such crises are the dread of bankers and of all men of large business responsibilities, and yet they are sometimes fatuously accused of causing them for their own benefit or advantage.

What is to be done to cure these defects and give us a safe and sound system of banking and currency? That is the main question now to be considered. The legal-tender notes of the Government are safe so long as the public credit is high and unimpaired, but it is desirable to get rid of them while that condition prevails. Redemption of the $346,000,000 and more outstanding is secured by a gold fund of $150,000,000 in the public Treasury, but they are redeemed only to be reissued, and the demand debt continues unpaid. The gold supply is now plentiful, and they could be gradually withdrawn and canceled without disturbance, their place being taken by gold coin, or certificates representing coin to the full value. The uniform bond-secured notes of the national banks are also a safe currency, but it is a rigid mass, which can only be expanded by investing capital in more bonds and contracted by taking these up and putting them on the market or holding them as a low-rate investment. There is no occasion for haste in their retirement, but it could be made gradually without loss, while the bonds were refunded at three per cent., which, with their limited volume, would maintain them at par as a

"gilt-edged" security for trust funds. The cost to the Government would be far more than compensated by the permanent benefit to the business of the country, and cost to the Government means cost to the people of the country.

So long as the volume of these notes was kept well within the steady currency requirement the quality of elasticity could be attained by a supplementary issue based upon bank credit and secured by banking resources, with adequate provision for constant redemption. Gradually the bond-secured volume could be reduced and that of credit circulation increased until the latter entirely replaced the former, if that is deemed desirable, without the least disturbance to confidence or stability. Whether individual banks should still be allowed to issue circulating notes at all, whether only those with a certain capital should have the privilege, or whether that function should be confined to one institution acting as a central agency for the whole system, is a question to be determined. It is intimately connected with the question of a proper reserve plan and a legally organized association of the banks to unify the national system and give it strength and power under proper regulation.

One thing has to be accepted as the result of conditions which have been developed in the fifty years' experience with national banking. The system cannot be turned topsy-turvy. We cannot displace the thousands of banks, with their local attachments and connections, and establish one great central institution with branches, to which all others shall be subservient or be crowded out of existence, however such an institution might be associated with the Government and made subject to official supervision. There cannot be another United States Bank of the old type, adapted to new conditions. There can be no exercising of banking power from the top down, from the apex of a financial pyramid to its broad base. The representative principle must be adopted and adapted, and the power must be exerted from the base to the apex, or, to change the figure, from the circumference to the center. With the vast extent of the country, the multitude of existing banks and the great variety of local conditions and local interests to be served, it is necessary to have, not one comprehensive association for the whole nation or union of States, but several associations within defined territorial limits, united in a central association to serve their common purposes.

This is a necessity of the situation, and it brings us to the controverted question of method of accomplishing a purpose upon which there is substantial agreement. The National Monetary Commission, which was created by Congress in 1908, devised a plan, reported at the end of 1911, which has not proved generally acceptable. That Commission, instead of being composed of a small number of competent experts in financial history and practice, was made up of nine Senators and nine members of the House of Representatives, few of whom had ever given serious study to the subject. Few took any active part in the Commission's work. A good deal of time and money was expended in gathering a voluminous mass of material, which would have been quite unnecessary for a competent body of experts, and which proved to be of little use. Still, a few men, capable of learning, worked up the plan which was unanimously signed by the members of the Commission and submitted to Congress. This costly work need not be thrown away, for it presents a useful outline and contains some good suggestions.

It proposes to associate the banks of the country together by districts, each with a convenient center where a central organization shall be maintained in corporate form. It provides a central agency or "National Reserve Association," in which the district associations shall be duly represented, to be located at Washington and have certain fiscal relations with the Government. This central agency would operate chiefly through branches, one at the center of organization of each district. These are in outline necessary features of the proposed system of which details may still be regarded as undetermined. Limits of space forbid dwelling here upon any but the most general considerations affecting the purposes to be attained; but, with these kept in mind and partisan rivalries excluded as wholly irrelevant to the objects aimed at, it ought not to be difficult to reconcile differences regarding essential details.

It may be said in a general way that the corporate organization of each district association should fairly represent the banks constituting it and the business community which the banks serve. It should, through competent committees, exercise supervision over its members with a view to soundness and safety in banking operations in the district, and serve as a means of communication and of working rela-

tions with the central association through its branch at the district center. The central association as a corporate body should be representative of the district associations. Their members should hold its capital stock pro rata of their own capital, and they should have the controlling voice in its organization and direction. It should also act as a fiscal agency of the United States Government, which should be duly represented in its management and should exercise a defined supervision in behalf of the public.

The manner of working out details of organization and management may be here left open, and attention directed only to reasons why this general form of a unified and centralized system is necessary. For the issue of a banking currency the central agency is not absolutely essential. This function might be safely retained in the individual banks in their several districts, provided an effective plan of redemption through the district centers was maintained. But for an effective system of reserve the central association is most important. There could be a plan for the holding of a certain percentage of cash reserve by each bank in its own vault, for current requirements, with a supplementary reserve at the district center, to be drawn upon at need; but the effect of this would be an attempt at dividing the banking operations of the country into sections. They do not and will not work in sections, and it is not desirable that they should. It would be liable to develop a rivalry of sectional interests. Our domestic exchanges and the continual interchange of credits cannot be confined within State lines or sectional lines. They flow constantly to and fro in response to the demands of a business which fluctuates but never stops. If reserves are to be mobile and fully to serve their purpose, they must be movable from place to place and from district to district or section to section, and there must be a central agency for their transfer, with a reservoir of its own for their storage, to and from which they may move so far as may be necessary to meet changing requirements.

There is another potent reason why this central organization is essential. One great defect in our banking system, which has attracted little attention because we have been so long inured to it, is the lack of means for making commercial paper assets and bills of exchange liquid and transferable by indorsement and rediscount. That is a matter

of great importance. Such a means could be supplied in a limited way by districts or sections through organized associations with their financial centers; but, as in the case of reserves, it cannot be effectively applied within such divisions of territory, because the purpose which it is to serve cannot be so confined. For an effective means of rediscount there must be a central national banking agency, not a score or more of district or " regional " agencies. There is need, not only of a means for the rediscount of commercial paper which will tend to equalize money rates throughout the country and to distribute reserve money according to requirements, but there is need of a central agency for dealing in foreign exchange and effecting international banking operations. Wtihout a central institution, with capital and resources of its own and with branches at the centers of district association through which to work, no rational banking reform can be accomplished, and to be lasting it must be rational as well as national.

If such an institution is to be had, whether it be called a " Reserve Association " or by some other name, it must have certain defined functions and the means of exercising them. It must have a large capital, which may best be contributed by the banks that it is to serve in proportion to their own capital. They should hold its stock. It must keep deposits of the member banks and have the means of rediscounting their paper, and these deposits may safely be reckoned in some part as reserves of the banks to which they are credited. It must itself have a strong reserve of "lawful money," which should consist entirely of the world's medium of exchange, gold, in the form of standard coin or bullion, and it must have the means of replenishing this by the legitimate exercise of its functions. It should be the fiscal agent of the United States Government and the depository of its Treasury funds. It ought to have the power to issue circulating notes of its own, whether those of individual banks were continued or not, secured by an ample gold reserve and constantly redeemable on demand. Their issue would greatly facilitate the operation of rediscounting for the banks through their associations, and their redemption would be effected through these at the branches.

The deposits of the banks with the central reserve agency would serve the purpose of reserves for them in a proper proportion and could be counted as such. It is a mooted

question whether its notes in the hands of the banks should be reckoned as part of the reserve money in their own keeping. Assuming that the central agency, or association, had at all times an adequate reserve of its own, with a proper ratio of gold set apart for the redemption of its notes, and about this no doubt should be left, it would be entirely safe, as well as convenient, to allow the individual banks to count those notes in their reserves against deposits. The purpose here is not to draw hard-and-fast lines, but to indicate the main outlines which must somehow be conformed to, if our banking system is to be put upon a solid and enduring basis.

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